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Q3 Quarterly Market Review

Third Quarter 2016

Quarterly Market Review

Third Quarter 2016

This report features world capital market performance and a timeline of events for the past quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features quarterly topics.

Overview:

Market Summary

Index Returns

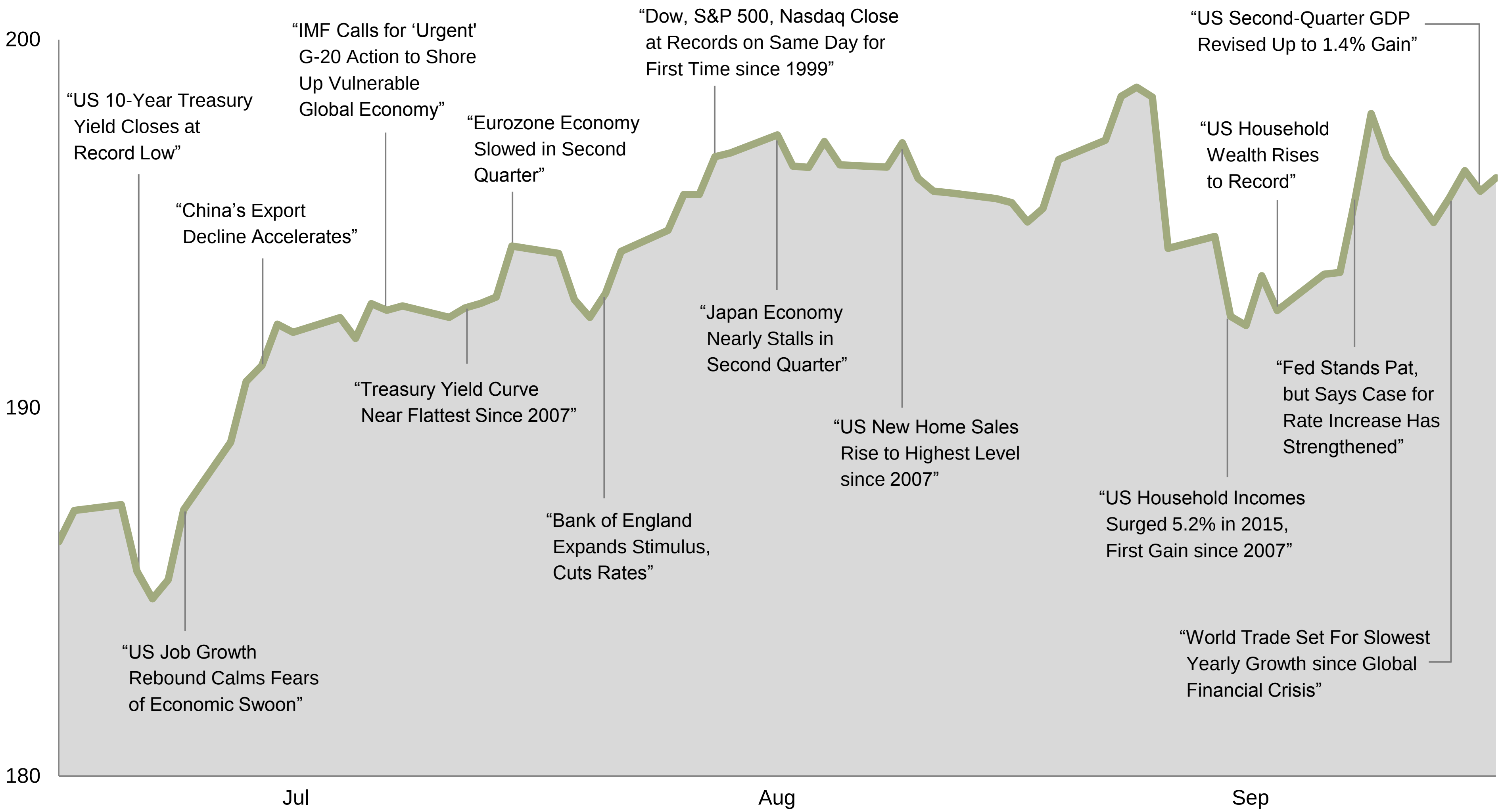
3Q 2016	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	4.40%	6.29%	9.03%	-0.23%	0.46%	0.10%

Since Jan. 2001	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Avg. Quarterly Return	1.8%	1.4%	3.0%	2.8%	1.3%	1.2%
Best Quarter	16.8% **Q2 2009**	25.9% **Q2 2009**	34.7% **Q2 2009**	32.3% **Q3 2009**	4.6% **Q3 2001**	5.5% **Q4 2008**
Worst Quarter	-22.8% **Q4 2008**	-21.2% **Q4 2008**	-27.6% **Q4 2008**	-36.1% **Q4 2008**	-2.4% **Q2 2004**	-3.2% **Q2 2015**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1−30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. Bloomberg Barclays data provided by Bloomberg.

World Stock Market Performance

MSCI All Country World Index with selected headlines from Q3 2016



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

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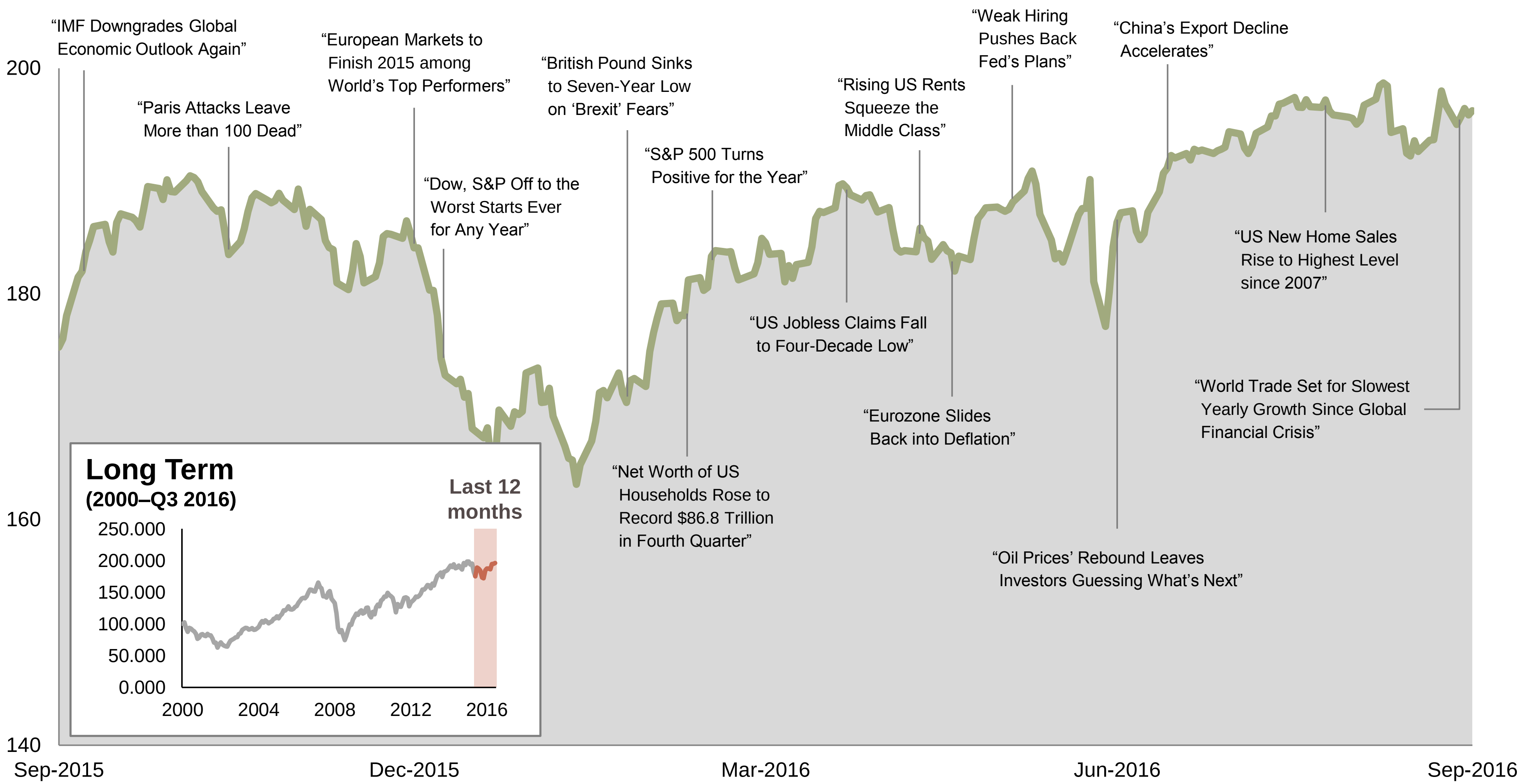
World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months

Short Term
(Q4 2015–Q3 2016)



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index. MSCI data © MSCI 2016, all rights reserved.

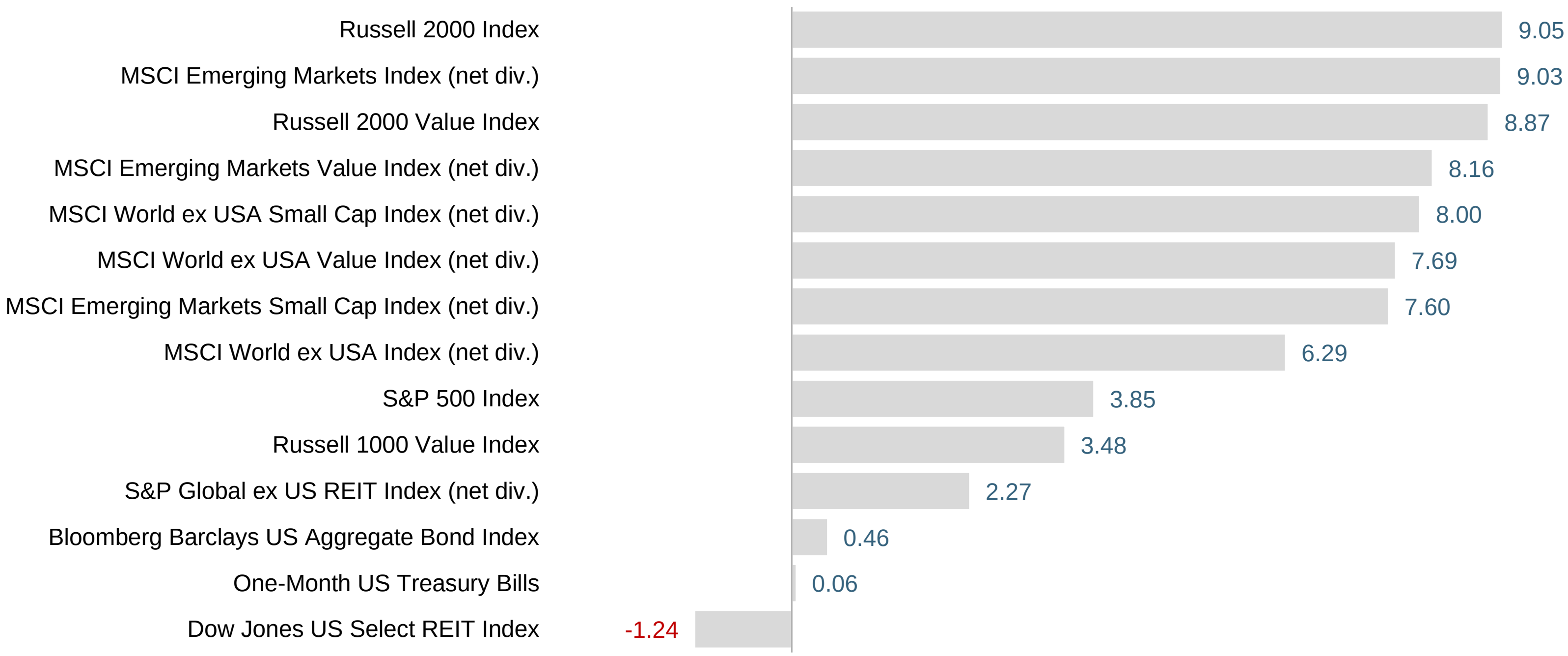
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results**.

World Asset Classes

Third Quarter 2016 Index Returns (%)

Looking at broad market indices, emerging markets outperformed all other equity markets during the quarter. The US equity market lagged developed markets outside the US. US real estate investment trusts (REITs) recorded negative absolute returns and lagged the US equity market.

The value effect was negative in the US and emerging markets but positive in developed markets outside the US. Small caps outperformed large caps in the US and in developed markets outside the US but underperformed in emerging markets



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US Stocks

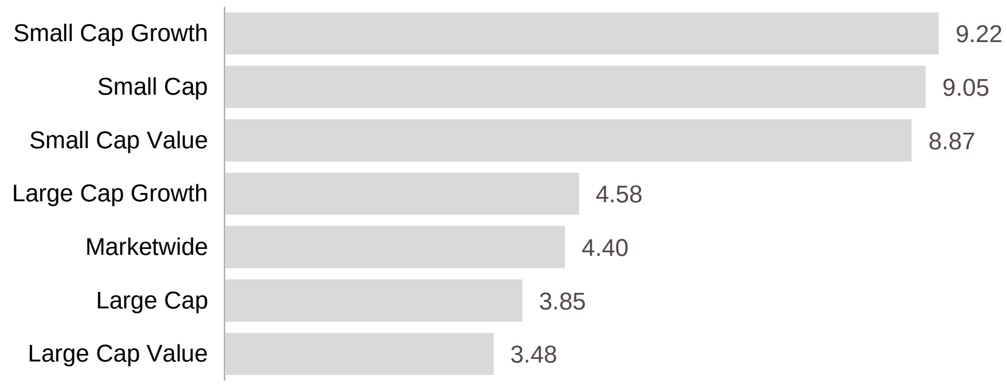
Third Quarter 2016 Index Returns

The broad US equity market recorded positive absolute performance for the quarter.

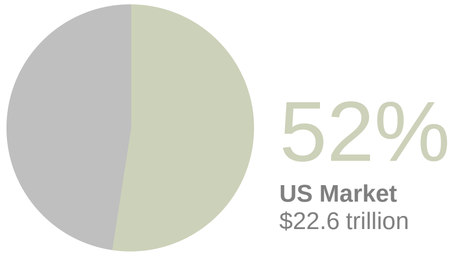
Value indices underperformed growth indices across all size ranges.

Small caps outperformed large caps.

Ranked Returns for the Quarter (%)



World Market Capitalization—US



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	8.18	14.96	10.44	16.36	7.37
Large Cap	7.84	15.43	11.16	16.37	7.24
Large Cap Value	10.00	16.20	9.70	16.15	5.85
Large Cap Growth	6.00	13.76	11.83	16.60	8.85
Small Cap	11.46	15.47	6.71	15.82	7.07
Small Cap Value	15.49	18.81	6.77	15.45	5.78
Small Cap Growth	7.48	12.12	6.58	16.15	8.29

International Developed Stocks

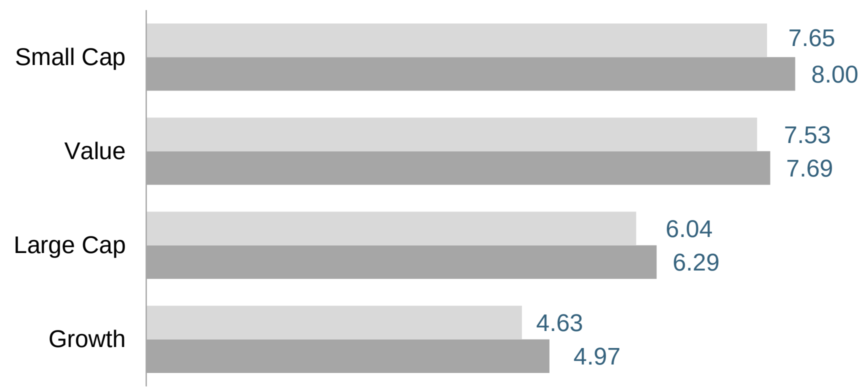
Third Quarter 2016 Index Returns

In US dollar terms, developed markets outside the US outperformed the US equity market but underperformed emerging markets indices during the quarter.

Small caps outperformed large caps in non-US developed markets.

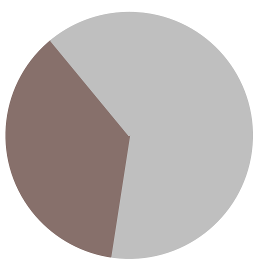
Looking at broad market indices across all size ranges, the value effect was positive in non-US developed markets.

Ranked Returns (%)



World Market Capitalization—International Developed

37%
International Developed Market
$15.8 trillion



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	3.12	7.16	0.33	6.89	1.88
Small Cap	7.26	13.50	4.15	9.72	4.11
Value	2.64	4.87	-1.69	5.64	0.66
Growth	3.61	9.42	2.30	8.08	3.04

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Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI World ex USA IMI Index is used as the proxy for the International Developed market.

Emerging Markets Stocks

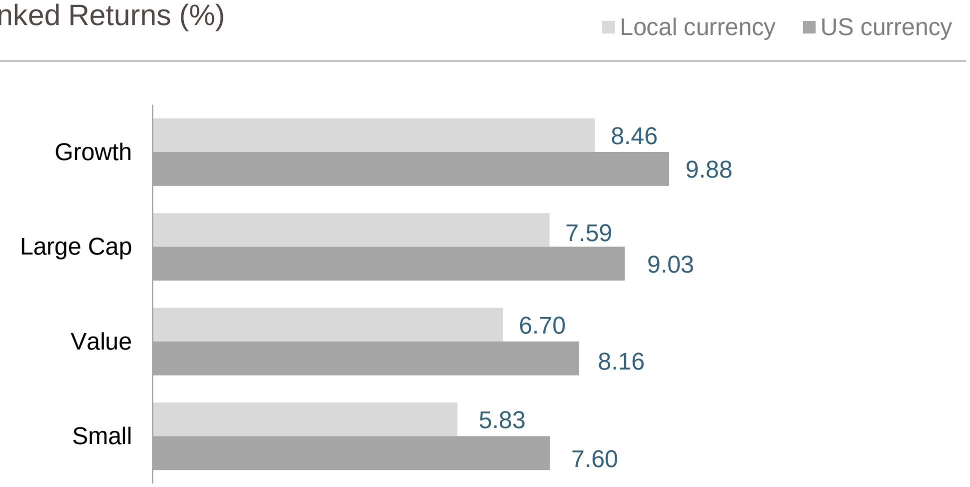
Third Quarter 2016 Index Returns

In US dollar terms, emerging markets indices outperformed both the US market and developed markets outside the US.

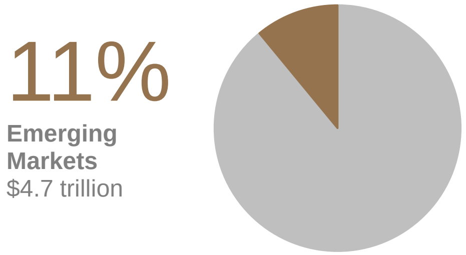
Using broad market indices as proxies, the value effect was negative in emerging markets. Large cap value indices underperformed large cap growth indices. The opposite was true among small caps; small cap value indices outperformed small cap growth indices.

Large cap indices outperformed small cap indices.

Ranked Returns (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	16.02	16.78	-0.56	3.03	3.95
Small Cap	9.08	12.65	1.29	4.72	5.97
Value	16.18	14.50	-3.00	0.79	3.77
Growth	15.84	18.92	1.81	5.19	4.03

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Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market.

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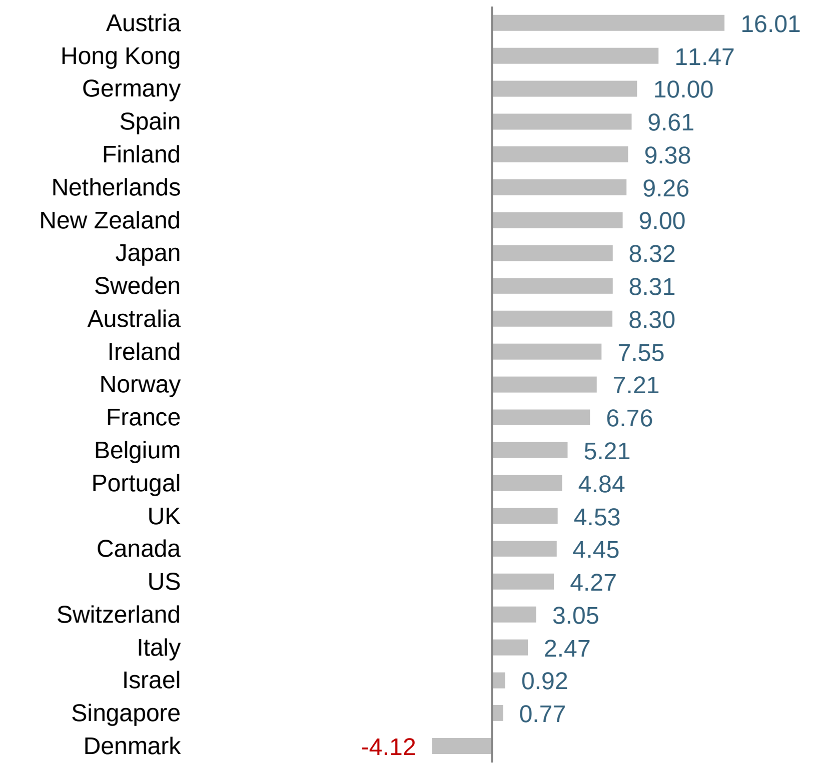
Select Country Performance

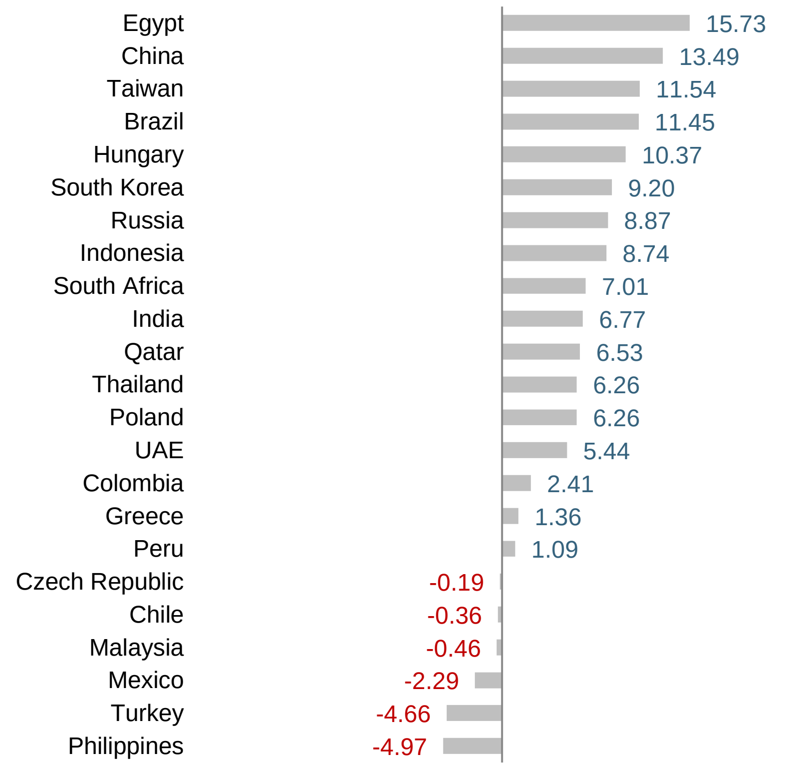
Third Quarter 2016 Index Returns

Austria and Hong Kong recorded the highest country performance in developed markets, while Singapore and Denmark posted the lowest performance for the quarter. In emerging markets, Egypt and China were the top performers, while Turkey and the Philippines recorded the lowest performance.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)



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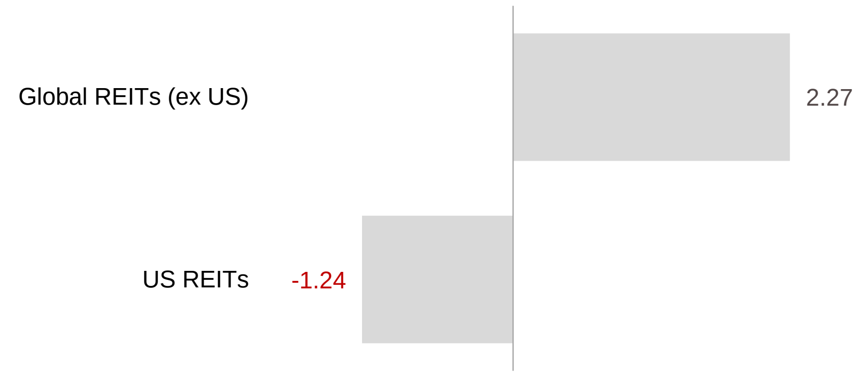
Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), Russell 3000 Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

Real Estate Investment Trusts (REITs)

Third Quarter 2016 Index Returns

US REITs posted negative absolute performance for the quarter, lagging the broad equity market. REITs in developed markets recorded positive absolute returns but underperformed broad developed markets equity indices.

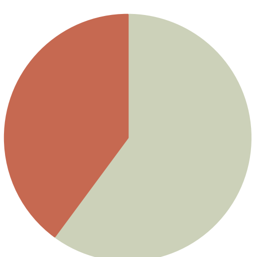
Ranked Returns (%)



Total Value of REIT Stocks

41%

World ex US
$455 billion
252 REITs
(22 other countries)



59%

US
$656 billion
100 REITs

Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	9.45	17.70	14.29	15.60	5.80
Global REITs (ex US)	12.52	14.61	6.03	10.46	2.55

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2016.

Fixed Income

Third Quarter 2016 Index Returns

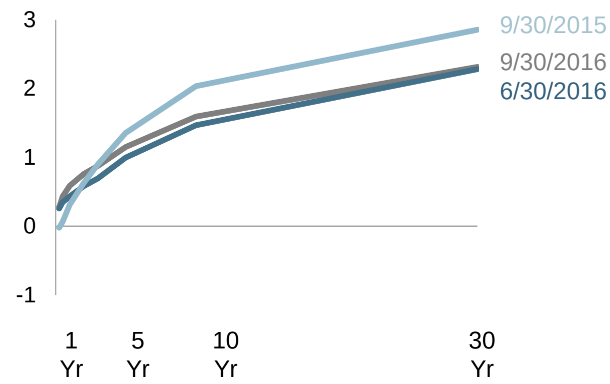
Interest rates across the US fixed income markets generally increased in the third quarter. The yield on the 5-year Treasury note rose 13 basis points (bps) to 1.14%. The yield on the 10-year Treasury note rose 11 bps to 1.60%. The 30-year Treasury bond increased 2 bps to finish with a yield of 2.32%.

The 1-year Treasury bill yield rose 14 bps to 0.59%, and the 2-year Treasury note yield increased 19 bps to 0.77%. The yield on the 3-month Treasury bill rose 3 bps to 0.29%, while the 6-month Treasury bill was up 9 bps to 0.45%.

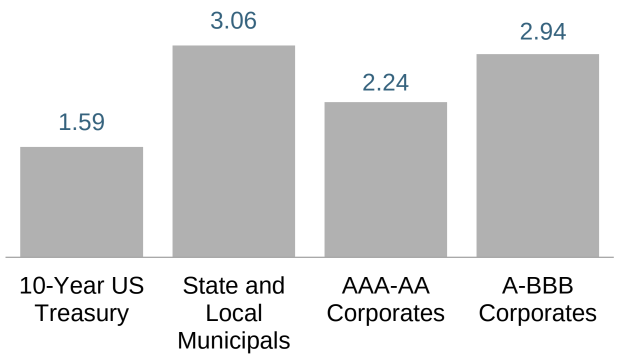
Short-term corporate bonds gained 0.32%. Intermediate-term corporates rose 0.89%, while long-term corporate bonds gained 2.56%.[1]

Short-term municipal bonds returned -0.21%, while intermediate-term municipal bonds were unchanged. Revenue bonds slightly outperformed general obligation bonds.[2]

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
BofA Merrill Lynch 1-Year US Treasury Note Index	0.71	0.54	0.35	0.33	1.53
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.24	0.27	0.12	0.10	0.92
Citigroup WGBI 1–5 Years (hedged to USD)	1.98	1.89	1.70	1.60	2.78
Bloomberg Barclays Long US Government Bond Index	14.61	13.02	11.07	5.48	7.97
Bloomberg Barclays Municipal Bond Index	4.01	5.58	5.54	4.48	4.75
Bloomberg Barclays US Aggregate Bond Index	5.80	5.19	4.03	3.08	4.79
Bloomberg Barclays US Corporate High Yield Index	15.11	12.73	5.28	8.34	7.71
Bloomberg Barclays US TIPS Index	7.27	6.58	2.40	1.93	4.48

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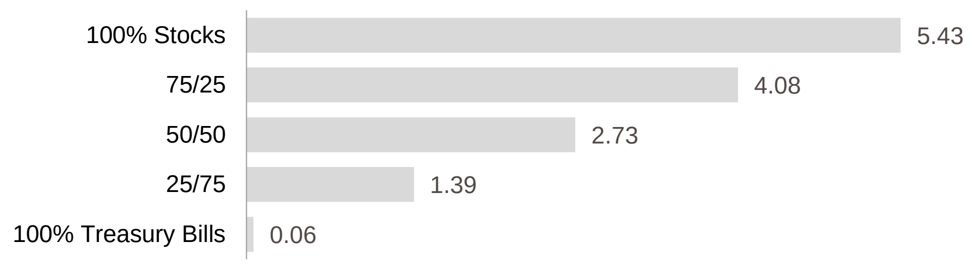
1. Bloomberg Barclays US Corporate Bond Index. 2. Bloomberg Barclays Municipal Bond Index. Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield). Citigroup bond indices © 2016 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2016 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation.

Global Diversification

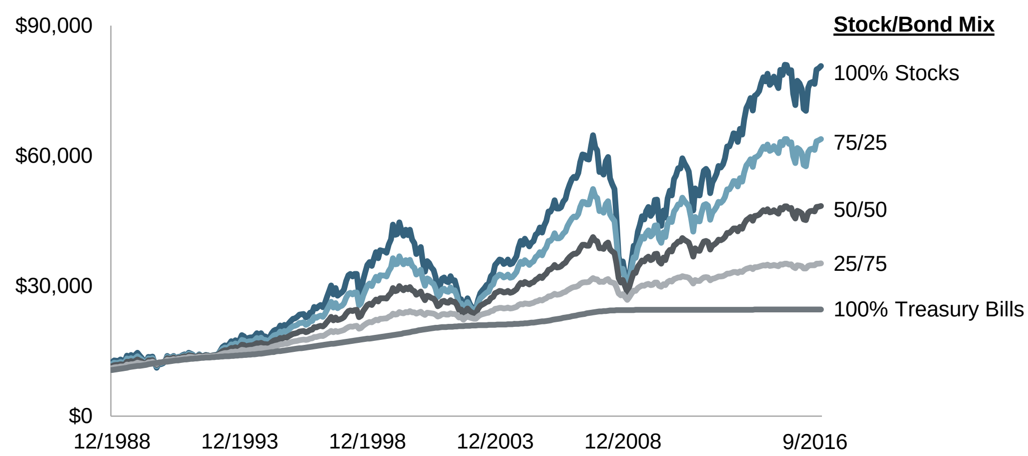
Third Quarter 2016 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)



Growth of Wealth: The Relationship between Risk and Return



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	7.09	12.60	5.74	11.23	4.90
75/25	5.42	9.53	4.41	8.48	4.15
50/50	3.70	6.43	3.02	5.70	3.21
25/75	1.94	3.30	1.57	2.89	2.09
100% Treasury Bills	0.14	0.16	0.06	0.05	0.79

Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio**. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2016, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

Presidential Elections and the Stock Market

Next month, Americans will head to the polls to elect the next president of the United States. While the outcome is unknown, one thing is for certain: There will be a steady stream of opinions from pundits and prognosticators about how the election will impact the stock market.

As we explain below, investors would be well-served to avoid the temptation to make significant changes to a long-term investment plan based upon these sorts of predictions.

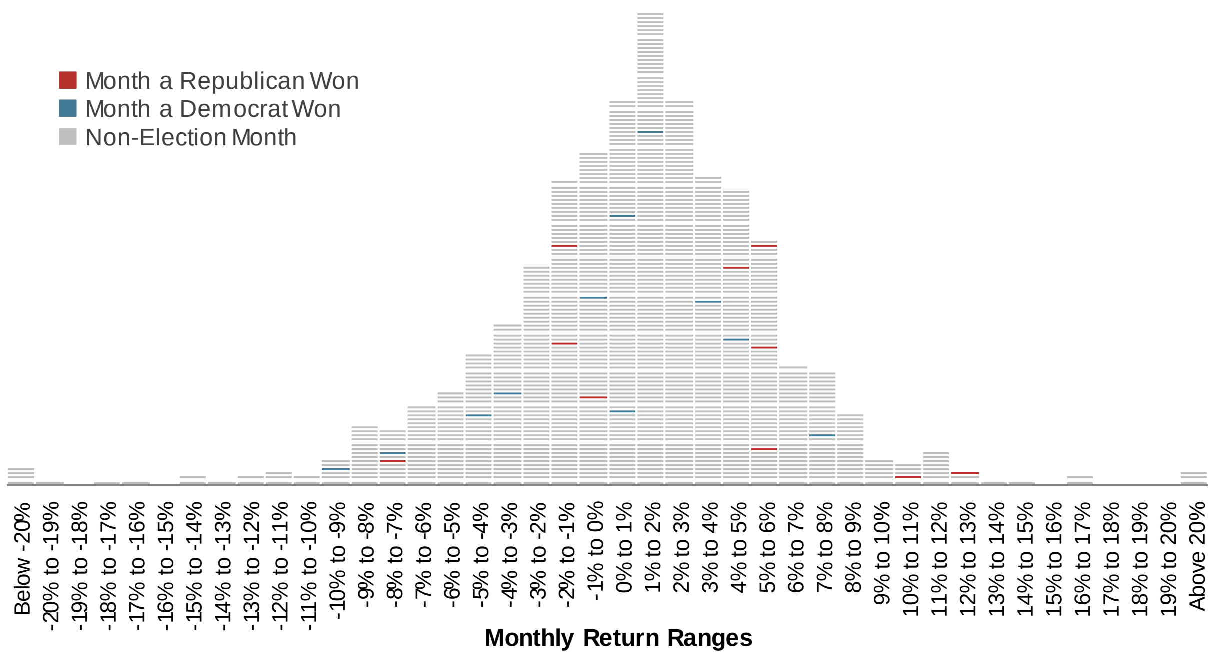
Short-Term Trading and Presidential Election Results

Trying to outguess the market is often a losing game. Current market prices offer an up-to-the-minute snapshot of the aggregate expectations of market participants. This includes expectations about the outcome and impact of elections. While unanticipated future events—surprises relative to those expectations—may trigger price changes in the future, the nature of these surprises cannot be known by investors today. As a result, it is difficult, if not impossible, to systematically benefit from trying to identify mispriced securities.

This suggests it is unlikely that investors can gain an edge by attempting to predict what will happen to the stock market after a presidential election.

Exhibit 1 shows the frequency of monthly returns (expressed in 1% increments) for the S&P 500 Index from January 1926 to June 2016. Each horizontal dash represents one month, and each vertical bar shows the cumulative number of months for which returns were within a given 1% range (e.g., the tallest bar shows all months where returns were between 1% and 2%). The blue and red horizontal lines represent months during which a presidential election was held. Red corresponds with a resulting win for the Republican Party and blue with a win for the Democratic Party. This graphic illustrates that election month returns were well within the typical range of returns, regardless of which party won the election. *(continues on page 16)*

Exhibit 1. Presidential Elections and S&P 500 Returns
Histogram of Monthly Returns, January 1926–June 2016



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Presidential Elections and the Stock Market

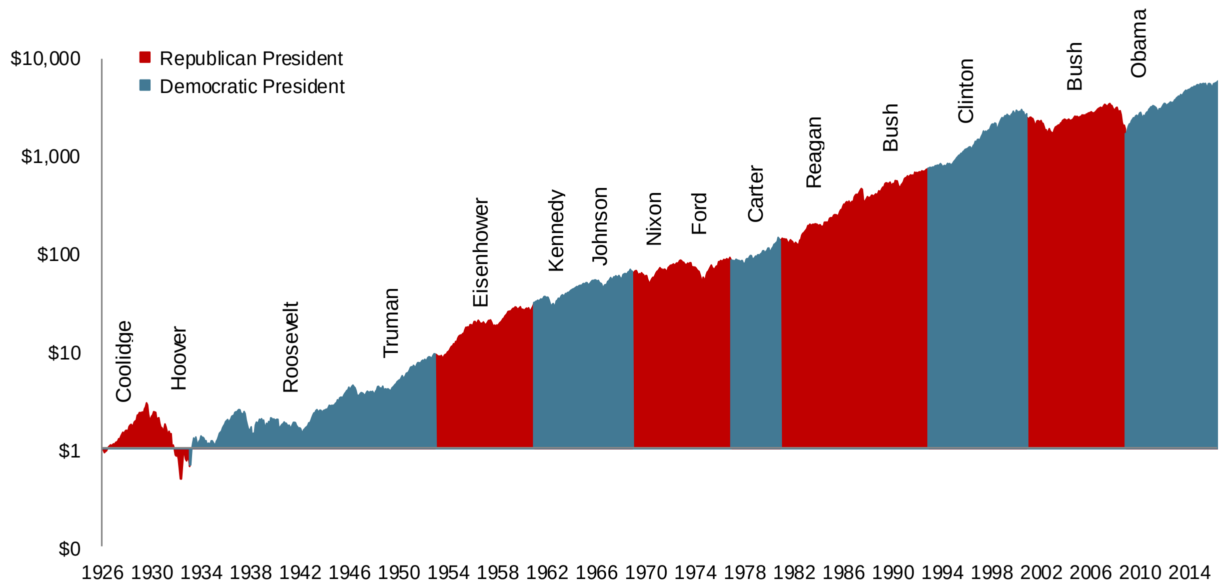
(continued from page 14)

Long-Term Investing:
Bulls & Bears ≠ Donkeys & Elephants

Predictions about presidential elections and the stock market often focus on which party or candidate will be "better for the market" over the long run. Exhibit 2 shows the growth of one dollar invested in the S&P 500 Index over nine decades and 15 presidencies (from Coolidge to Obama). This data does not suggest an obvious pattern of long-term stock market performance based upon which party holds the Oval Office. The key takeaway here is that over the long run, the market has provided substantial returns regardless of who controlled the executive branch.

Conclusion

Equity markets can help investors grow their assets, but investing is a long-term endeavor. Trying to make investment decisions based upon the outcome of presidential elections is unlikely to result in reliable excess returns for investors. At best, any positive outcome based on such a strategy will likely be the result of random luck. At worst, it can lead to costly mistakes. Accordingly, there is a strong case for investors to rely on patience and portfolio structure, rather than trying to outguess the market, in order to pursue investment returns.



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Negative Real Returns

Nominal interest rates are currently below zero in many countries, including Germany, Denmark, Switzerland, Sweden, and Japan.

These levels have turned the common belief that zero is the lower bound for such rates on its head. While negative nominal rates are a relatively new phenomenon, periods of widespread negative real returns across countries have been quite common.

WHY CARE ABOUT REAL RATES OF RETURN?

In 1970, a loaf of bread cost 25 cents. A gallon of gas cost 36 cents. Today, an average loaf of bread and a gallon of gas each cost around two dollars.[1] When the prices of goods and services increase, consumers can buy fewer of them with every dollar they have saved. This is called inflation, and it eats into investors' returns.

Real rates of return are adjusted for inflation, so they account for changes in the purchasing power of a dollar over the life of an investment. Because inflation affects the cost of living, investors must consider the inflation-adjusted—or real—return of their investments. When inflation outpaces the nominal returns on an investment, investors experience negative real returns and actually lose purchasing power.

BRIEF HISTORY: TREASURY BILL RETURNS

Exhibit 1 shows the annual real returns on one-month US Treasury bills. From 2009 to 2015, the annual real return was negative. This circumstance is not unprecedented. Since 1900, the US has had negative real returns in over a third of those years. And negative real returns on government bills are not exclusive to the US. All countries listed in **Exhibit 2** have had negative real returns on their respective government bills in at least one out of every five years from 1900 to 2015.

BOND INVESTORS MAY GET MORE THAN THE BILL RETURN

In the current low-yield environment, rolling over short-term bills may not seem appealing to investors keen on protecting their purchasing power. **Exhibit 3** shows that the return of one-month US Treasury bills has not kept pace with inflation[2] over the past 10 years. But even when the real return on bills is negative, a relatively common occurrence, bond investors may still achieve positive expected real returns by broadening their investment universe. The bond market is composed of thousands of global bonds with different characteristics. Many of those bonds allow investors to target global term and credit premiums, which in turn may provide positive real returns even in low interest rate environments. Exhibit 3 also shows that the Barclays Global Aggregate Bond Index has outpaced inflation while maintaining low real return volatility of 3.4% annualized over the past 10 years.

1. Source: Bureau of Labor Statistics.
2. Measured as changes in the Consumer Price Index (CPI), which is defined by the US Department of Labor, Bureau of Labor and Statistics.

Negative Real Returns

(continued from page 16)

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Exhibit 1. Annual Real Returns of One-Month US Treasury Bills

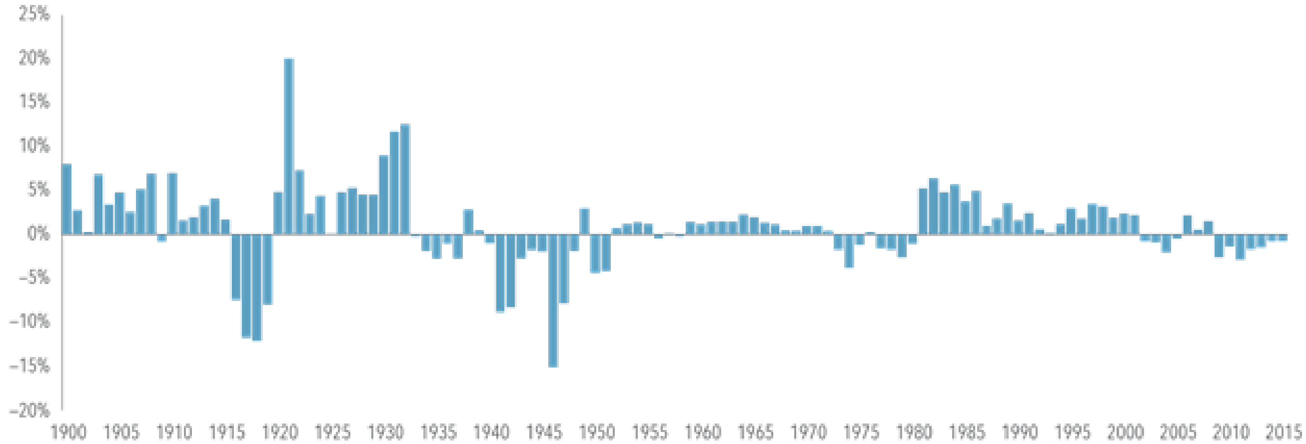
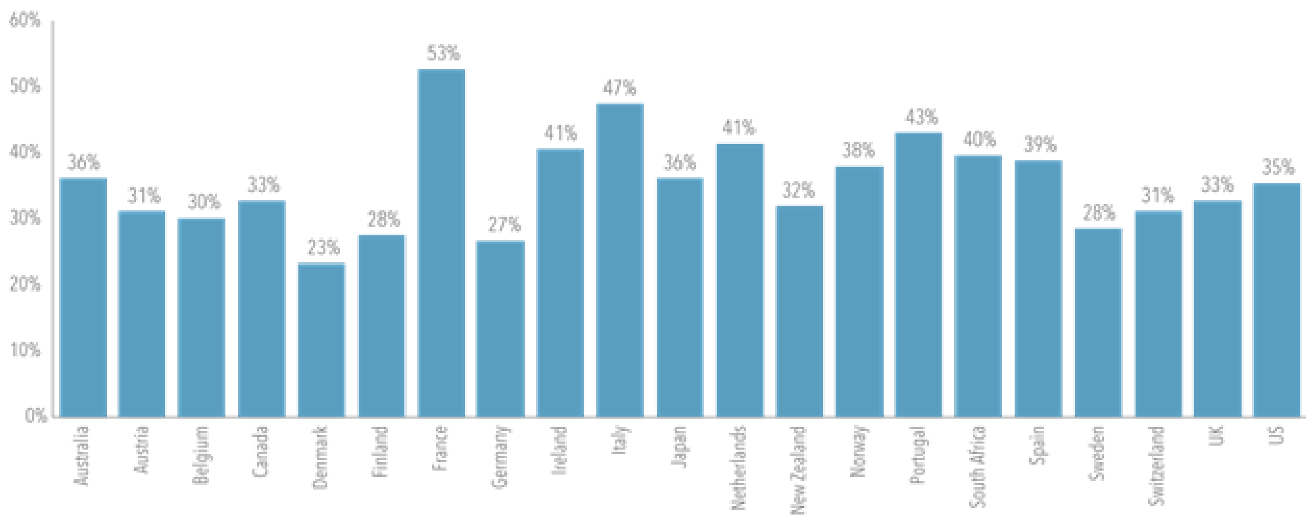


Exhibit 2. Percent of Years with Negative Real Returns on Government Bills, 1900–2015

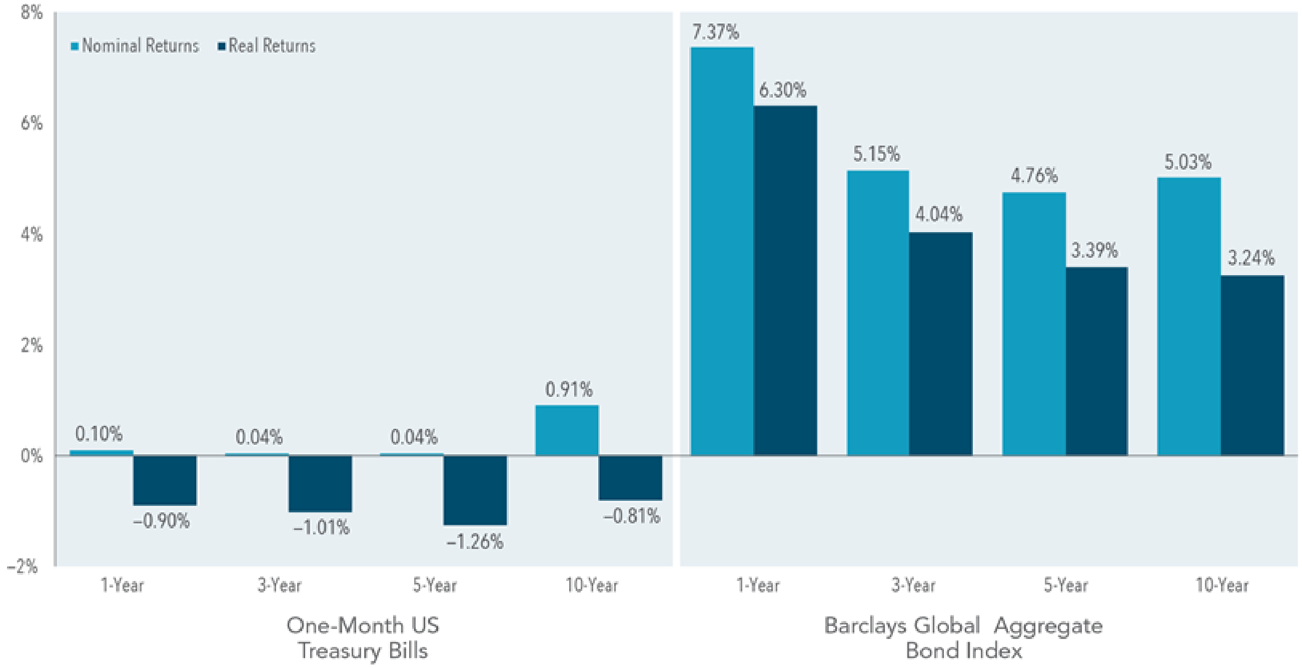


Source: Dimson, Marsh, and Staunton (DMS); Morningstar.

Negative Real Returns

(continued from page 17)

Exhibit 3. Trailing Annualized Returns



Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Trailing returns are as of June 2016. The Barclays Global Aggregate Bond Index is hedged to USD. Real Return = [(1 + Nominal Return)/(1 + Inflation)] − 1. Sources: Barclays, Morningstar. Barclays indices copyright Barclays 2016.

Global diversification is often thought of as a tool for reducing risk. However, when it comes to fixed income, global portfolios can also play an important role in the pursuit of increased expected returns. Even if the expected real returns of bonds in one country are negative, another yield curve may provide positive expected real returns. The flexibility to pursue higher expected returns by investing in bonds around the world can be an important defense against low, and even negative, yields.

SUMMARY

The goal of many investors is to grow some (or all) of their savings in real terms. Even in a low interest rate environment, there may be bond investments that can still achieve this goal. In particular, investors who target global term and credit premiums should be better positioned to pursue higher expected returns.

Source: Dimensional Fund Advisors LP.

Past performance is no guarantee of future results. There is no guarantee an investing strategy will be successful. Diversification does not eliminate the risk of market loss.